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The Military Situation

THE sweeping advances of the Russian armies and the great successes of the Allies in the Mediterranean have made September a month of victory and high promise for the United Nations, and a correspondingly black period for the German arms. From the autumn of last year, when the Allies seized the initiative at Stalingrad, at El Alamein and in French North Africa, the sequence of favorable military developments has been orderly, swift and almost uninterrupted. The German armies have never been able to mount a counter-offensive, except for limited purposes. They have been forced back without respite, out of Africa and Sicily and now up the Italian peninsula, and in Russia across the Don and the Donetz and now across the Dnieper. The Allied assaults in the Mediterranean have driven Italy out of the war, and probably Germany's Balkan satellites are ready to follow Italy's example at the first auspicious time.

These are momentous developments. They have been made possible by the steady marshalling of the strength of the United Nations, by their control of the sea, their increasing superiority in the air, and the immense and growing power of their munitions production. Inferior in all these respects, and slipping farther behind steadily, the Germans can no longer hope to recover the initiative and resume the strategic offensive. They have but one course open, to dig in where they can and fight as long as they think they can gain by fighting, in hope of a stalemate or of wearying the Allies into granting easy terms. It seems clear that this will be the pattern for the remainder of the European war.

The Length of the War

In this country there is growing speculation as to how long the Germans can or will keep up the struggle. Whatever others may think, the military authorities can have but one opinion. The victories of the past month are not decisive in the sense that the enemy's capacity to resist is wiped out; actually that capacity may be increased, for a time, by the shortening of his lines. They are not decisive to the extent that a collapse behind the lines, even next year, is definitely foreshadowed. In due course the United Nations can bring to bear the overwhelming forces needed to break Germany's defensive power, but as yet they have not been able to do so.

If the war can be ended only by inflicting an overwhelming military defeat upon fighting German armies on European battlefields, the cost in time will be long and in money and casualties heavy. The Chiefs of Staff have no recourse but to prepare for such a struggle, and the country can safely expect nothing less. If German internal collapse intervenes it will be a welcome windfall, but still a windfall; to count upon it, and to relax the war effort, is unthinkable, for this would jeopardize victory and would be the surest way to prolong the war. War production is still the first task of the economic organization.

Fortunately, there is little reason to think that industrial management or labor needs fresh exhortations to continue devoting every possible effort to winning the war. The fear that complacence was hurting production has been mostly dissipated by the gains achieved during the past three months, and any tendency to let down after Italy's surrender was checked when it became evident that we should have to fight for Italy about as if the Italians were still in the war.

Only in two respects do the great successes of the past month, and the possibility that "anything may happen," immediately affect the domestic situation. First, it has obviously become even more prudent and desirable for people charged with business planning to study the impact of a possible end of the European war on their affairs, and to make what preparations they can without weakening their support of the military effort. Second, those in government and industry who have the responsibility of laying plans for termination of contracts and disposition of plants and materials, and in other ways facilitating adjust-

ments to post-war conditions and smoothing the reconversion of the war industries to peacetime manufacturing, should feel a new sense of urgency.

General Business Conditions

Latest reports on the production of war materials have been favorable. The War Production Board's index of munitions output for August showed an increase of 4 per cent over July, following gains of 3 per cent in July over June and 2 per cent in June over May. In his message to Congress, President Roosevelt said further gains were being made in September. Mr. Nelson, Chairman of the W.P.B., stated in London that United States war production alone is half again as large as that of Germany and Japan combined, and Mr. Wilson, the Vice Chairman, in a subsequent address placed the percentage of superiority even higher.

Mr. Wilson also gave figures placing the 1943 output of war materials at $63 billions, the rate during the latest quarter at $75 billions, and the 1944 schedules at $80 billions. The increase needed over the present rate is not extraordinary, but this is a case where aggregates are not revealing; for the 1944 total doubtless includes much smaller expenditures on construction, plant equipment and certain types of munitions, and the expansion wanted in other lines is far greater than the totals imply. An increase of 50 per cent in airplane production over 1943 is called for. Gains of this magnitude on top of the almost fantastic growth already achieved will be made only by superlative organization and devoted work by all concerned.

Meanwhile the difficulties in advancing the overall industrial output of the country are apparent. The Federal Reserve Board's production index for August was unchanged from the July figure, which was itself revised downward; the durable goods component of the index was three points higher but non-durable goods output was two points lower. This illustrates the fact that as productive resources become fully occupied, gains in one quarter can be made only by diverting productive activity from another quarter, — a self-evident truth which will apply increasingly to the situation unless united effort and improved organization can lift the overall ceiling. One of the factors in the drop in non-durable goods production has been scarcity of labor for the textile industries, which results from the shift of workers into the armed forces and the war plants.

Where is the Ceiling?

The showing of the Reserve Board's index, which has moved generally sideways since last winter, is cited as evidence that industrial output has reached its approximate ceiling. Yet this conclusion is one which those familiar with the industrial situation can hardly bring themselves to accept, for the evidence of slack that might be taken up by increasing labor efficiency and improving labor utilization is impressive. The basic question is whether the manpower problem is a shortage of workers, or a failure to make the best use of those available. The quit rate in industry, for example, which according to the Bureau of Labor Statistics was in July at an all-time high of 7.43 per cent, equivalent to nearly 90 per cent per annum, obviously reduces industrial efficiency. Absenteeism and the "feather-bedding" type of restriction of individual output enforced by some labor unions, even under war conditions, are other problems. A better organization of the labor supply is needed.

During the month a report on the manpower problem on the West Coast prepared by Bernard M. Baruch, as special advisor to Mr. Byrnes, the Director of War Mobilization, has been made public. This report reiterated that deferment from selective service should be on the basis of occupation rather than dependency. It advised the adoption of systems of labor priorities, locally administered, to insure that workers as well as materials should be directed to the most essential production. It is friendly to incentive wage plans. It recited causes of excessive labor turnover. It said further that all over the country much labor is being hoarded or poorly utilized, and named the Government as a sinner along with private employers.

Mr. Baruch's report has cleared the air and laid down guiding principles. Programs based on it are being set up and will be extended. Its own recommendations, especially those for improvement of transportation, housing and civilian services which are difficult to carry out in wartime, are evidence that the solution is far from easy. Nevertheless, a condition which causes production of airplanes, which will shorten the war, to be held down by lack of workers, while slack remains to be taken up and the definition of "essential work" is no more rigid than is now the case, is hardly tolerable; and the critical need is the best assurance that improvement will be accomplished.

Consumers' Goods Trade Holds Up

Department store sales have shown a seasonal upturn and a widened margin of gain over a year ago, despite the fact that consumers have paid more taxes and bought more bonds during the month. Consumption of civilian goods this year will be much greater than most observers expected; the Department of Commerce now calculates that total consumer expenditures for goods and services will exceed $90 billions, an increase of more than $8 billions, or 11 per cent, over 1942. This is a greater increase than the indicated rise in living costs, which is about 7 per cent, and although hidden

price increases of one kind or another need to be taken into account, the evidence is that people will enjoy a volume of goods and services fully equal to the 1942 total. In other words, the country's productive organization has accomplished the phenomenal achievement of not only turning out war goods in the volume already stated, but of maintaining, in the aggregate and without considering shifts, inconveniences and substitutions, the standard of living.

Early this year the Department of Commerce estimated that sales of all retail stores during the year would be 13 per cent less than in 1942. The wide discrepancy between the prediction and the reality is accounted for in part by drawing down inventories, in part by the shift of buying to higher-priced lines, and in part by the ingenuity of manufacturers in using substitute materials and designing new products to offset war shortages.

Wholesalers' inventories at the end of July were 14 per cent below a year ago and retailers' stocks 21 per cent lower, according to Department of Commerce figures. Even with these declines stores will have goods to supply a very large trade during the remainder of the year. In many lines, however, buyers coming to the wholesale markets cannot get all they want, and the number of items in short supply is increasing.

Food Prospects Better Than Forecast

With the 1943 growing season now drawing to a close, the country again is harvesting bumper crops, exceeded in size only by last year's record production. Lower crop yields, moreover, are being more than offset by increased livestock production, with the result that total food production this year will be even larger than last. While the civilian share of this supply, after 25 per cent of this year's production is set aside to meet military and lend-lease requirements, will not permit consumption to remain at the record levels of the past two years, there nevertheless will be enough food left to maintain per-capita civilian consumption at somewhat above pre-war levels.

The crop shortages so widely predicted during the cold, wet spring were averted by favorable weather, on balance, during the summer months. There has never been a better demonstration of recuperative power than in the recovery of the corn crop after the long delay in planting. The Government's first estimate of 2,706,000,000 bushels of corn, based on July 1 conditions, was some 15 per cent smaller than the 1942 crop, but the latest estimate, as of September 1, raises the figure nearly 300,000,000 bushels, and if not reduced by early frosts — its one remaining hazard — the crop will be only 5 per cent smaller than last year.

This improvement is a great help, in view of the 10 per cent larger livestock population to be fed. It will not eliminate the need to market animals at lighter weights and lower finish than during the past two years, and to reduce livestock numbers, but it will permit the adjustment to be carried out in a more orderly manner. The major problem will be to distribute feed supplies equitably, and so as to best serve the country's needs; the difficulty in the present situation is that price ceilings, and the profits to be had in converting feed into pork, cause the corn grown in the commercial corn belt to be kept there for feeding to hogs, with corresponding shortages for cattlemen, dairymen and poultrymen elsewhere. As long as this continues the reduction in livestock numbers will come about very unevenly, the greatest burden falling on the areas where feed has to be brought from a distance.

The improvement in the food supply outlook, together with the marketing of the new crops, has been accompanied by a modest, though welcome, decline in prices. Contributing to the decline have been the meat and butter price rollback subsidies, stricter compliance with price ceilings, and the large addition to the country's vegetable supply through the successful Victory Garden program. Lower food prices, in turn, have been reflected in the Bureau of Labor Statistics' cost of living index, which, after rising 6.2 per cent from last September to late spring, declined 1.5 per cent during June, July and August.

New Subsidy Proposals

The policy of the Administration is to meet, if possible, the demand of the labor organizations that the cost of living index be rolled back to the September 15, 1942 level. For that purpose Mr. Chester Bowles, General Manager of O.P.A., last month announced a new program involving lower retail prices for apples, onions, potatoes, peanut butter, lard, and shortening, to be achieved through a combination of subsidies at processing, transportation and distributing levels. How much effect any cuts that may be practicable in these commodities can have on the cost of living is uncertain, since in the aggregate they represent only 4 or 5 per cent of the typical family budget used as the base of the index. Mr. Bowles has placed the cost of the new program at $100,000,000 annually, funds for which apparently are available. To supplement these price reductions, new ceilings on fruits and vegetables, at levels some 15 per cent below last winter's highs, are in preparation.

A new Administration food program is in the making, and although it has not yet been formally presented to Congress, War Food Administrator Jones has made it clear that no solution, except subsidies, of the problem of

stimulating food production while keeping food prices down has been found. His proposal is to guarantee support prices to farmers, and to back them up by government purchases, at levels which in some cases will be higher than the ceiling prices to consumers. The Government's loss on the resale of such purchases will be the subsidy. Mr. Jones has asked that the borrowing power of the Commodity Credit Corporation be increased $500 millions, in addition to $500 millions already available, to enable it to absorb losses.

This proposal differs in detail from the subsidy programs which were fought over in Congress last spring, but it is subject to the same criticisms of principle. The issues involved are illustrated in the milk situation. Milk production recently has taken an unfavorable turn, and with feed prices higher and pastures deteriorated due to drouth, producers' margins have been sharply narrowed. Thus the Food Administration has had to decide whether to permit milk prices to rise, to allow production to fall, or to pay subsidies. It has chosen the latter course. Subsidy payments will be flexible, in that they will be greatest in areas where feed costs have advanced most and milk prices least. The plan will involve the Government in immense and costly administrative detail. The subsidy payments are basically inflationary. They have the advantage, however, of making it possible to avoid an increase in dairy product ceilings, which might spiral further.

The attitude of Congress on proposals for extensive farm subsidies is uncertain; the debate will get under way during the coming month, and there will be further occasion to discuss it.

Success of the Third War Loan

The goal of $15 billions set for the Third War Loan, for sales of government securities to investors other than commercial banks, was reached before the end of September, and establishes a new high record for war financing in this or any other country. The success of the drive is a tribute to the sales organization that had been built up, to the invaluable support given by newspaper and radio advertising, and to the patriotic and voluntary response of the American people. Final figures through the close of the drive on October 2, which will show the extent of the oversubscription and furnish details as to the distribution of subscriptions, will not be available until after this Letter goes to press. Preliminary figures, however, indicate the main trends.

Since the principal emphasis of this drive was to sell securities to the largest possible number of people in every part of the country, not only to raise funds but also to check the continued rise in purchasing power and private spending, and since the quota for individual sales was set at $5 billions or one-third of the grand total, the major portion of the selling effort was devoted to reaching the individual investor. For this reason, the lag in individual sales which was apparent throughout the drive has detracted somewhat from the satisfaction at passing the overall goal. By the end of the second week of the campaign, when subscribers other than individuals had gone over the top with purchases of $10.5 billions against a quota of $10 billions, the purchases by individuals were only $2.8 billions, or 56 per cent of quota.

This follows, however, the normal expectancy. Institutional investors have their funds mobilized and are ready to respond immediately, but it takes longer to reach the individual investor. Moreover, many individual subscriptions were in the form of pledges payable over a period of weeks. For this reason purchases of the three savings bonds through October 16 will be counted as part of the drive totals. Sales to individuals are well ahead of the corresponding figures for the April drive, but it remains to be seen whether the high goals set for such sales will be reached.

Nevertheless, the certainty that there will be a substantial increase over the high totals of last April should be extremely encouraging, both to the government authorities and to the nation-wide organization of volunteer workers, including employes of banks, investment dealers, insurance companies, department stores and many others, whose efforts combined to make such a successful campaign possible. The showing is particularly impressive in view of the fact that in April the current withholding tax on wages and salaries had not yet gone into effect, and no quarterly instalment of personal income taxes was payable. Sales of Series E, F, and G savings bonds paid for between September 1 and the 27th amounted to $1,583 millions, compared with $1,033 millions in the corresponding period of April, thus assuring that the total for the full month will far exceed the previous peak of $1,479 millions established in April. These figures comprise, of course, the regular purchases of savings bonds by individuals through payroll deduction, as well as extra purchases made during the drive.

Institutional and State Quotas

Both the insurance company and the savings bank groups have already exceeded the quotas set for them. In this loan the insurance company purchases include for the first time, in accordance with provisions authorized by the Treasury, orders placed for securities to be delivered and paid for anytime during the month following the drive or up to November

1. Of the total sales of marketable bonds to investors other than the insurance companies, there has been a definite preference, measured in dollar volume, for the 10-year 2s over the 26-year 2½s. Corporations have been buying liberally of the short-term issues, but have tended to choose more of the ⅞ per cent one-year marketable certificates and less of the redeemable tax savings notes, which pay interest at graduated rates, depending upon the length of time held before being presented for redemption and ranging from 0.60 per cent for six months up to 1.07 per cent for three years.

New York State had a quota of $4,709 millions, or about 31 per cent of the total for the entire country, and passed this quota several days before the ending of the drive. Actual sales in New York exceeded, by an amount variously estimated at $500 millions or more, the total for which this district received sales credit, due to the fact that many corporations whose head offices are located in New York City and whose subscriptions were placed there distributed the major part of the sales credit to other localities where their factories, branch stores, etc., are located.

As the Third War Loan drive was restricted, for the first time, to investors other than commercial banks, with the latter to be offered certificates and medium-term bonds after the close of the general drive, the amount of such offering will depend in part upon the extent of over-subscription received on the sales to nonbanking investors. Formal announcement giving exact terms will be made by the Treasury early in October.

The Loan and the Money Markets

The extensive shifts of funds resulting from subscriptions to the Loan, and from the quarterly tax payments, place the money markets temporarily in an easier position, since the major shift has been the transfer of bank deposits from private account, against which reserves have to be kept, to United States Treasury account, against which no reserves are required. This release of reserves has enabled the commercial banks to increase substantially their holdings of outstanding government securities; to expand their loans, largely for the purpose of purchasing and carrying securities; and at the same time to have larger excess reserves than before the drive started. During the two weeks ended September 22nd, demand deposits adjusted (privately owned deposits) of the weekly reporting member banks declined by nearly $5 billions while Treasury deposits increased by $7½ billions. The gain in excess reserves for the banking system as a whole was $450 millions.

Increases in holding of U. S. securities by the reporting banks included some $800 millions of Treasury bills, $600 millions of certificates of indebtedness and $300 millions of bonds. Loans to brokers and dealers and other loans for carrying securities rose by more than $1 billion, and commercial, industrial and agricultural loans increased nearly $400 millions. Even though the normal seasonal trend of business loans is upward at this time, it seems probable that borrowing by corporations in connection with their subscriptions to government securities was a factor in the increase.

The easing of the money market during the War Loan drives is of course a technical and temporary development. As the Treasury calls the deposits which it has now accumulated in the commercial banks, and pays them out for purchase of munitions and other purposes, the deposits will again pass into private hands and reserves will be required against them. Excess reserves will be drawn down once more; and the banks whose policy is to keep rather fully invested and carry little or no excess reserves will as heretofore acquire additional reserves chiefly through the sale of Treasury bills to the Federal Reserve Banks. The rate at which excess reserves will decline and Federal Reserve support be called for will depend upon several variable factors, including the rate of Treasury withdrawals from the banks; the amount of currency going into circulation, which decreases reserves; and the extent of growth in deposits.

The Railroads' War Achievement

Shortly after Pearl Harbor, Dr. Paul Goebbels, Germany's Minister of Propaganda, offered a prophecy concerning the defense effort of the United States. The American railroads, he pointed out, were entering the war with 10,000 fewer locomotives than they had at the beginning of World War I, and with 500,000 fewer freight cars. This shortage of rolling stock, he observed, would be embarrassing under the most favorable conditions; at a time when the country faced such new problems as the paralysis of coastwise shipping and the shortage of tires and gasoline, it would prove, he predicted, an insuperable handicap. Transportation — and particularly railroad transportation — declared Dr. Goebbels confidently, would prove the Achilles' heel of the American production effort.

Even in the United States there was real concern as to whether transportation facilities could stand up under the strain of total war. People whose memories went back to the first world war recalled the chaotic conditions that prevailed then. They recalled how, partly through lack of railroad teamwork and partly through government confusion, freight cars swamped the sidings on the Atlantic seaboard —200,000 of them at one time—waiting to be unloaded. And they recalled how in December, 1917, the Government finally took over the

carriers and muddled through the rest of the emergency to the loss of everyone concerned.

The war is not yet over; and it would be premature to write of this chapter in American transportation as if it were a closed one. With railroad equipment being subjected to wear and tear at an unprecedented rate and with replacements limited, it is not inconceivable that transportation inadequacies may become more serious. Railroad officials know that they need more equipment, and they believe public policy should permit them to have it. But more than three years after the beginning of the defense effort, the railroad reports have supplied little comfort to the enemies who hoped they might prove a weak link in the war effort.

The Traffic Load

In World War I the railroads buckled under the strain of a traffic burden which, at its peak in 1918, totaled 405 billion ton-miles of freight and 43 billion passenger-miles. In 1942, with 35 per cent fewer locomotives and 26 per cent fewer freight cars, they handled 638 billion ton-miles of freight, an increase of 58 per cent over the 1918 movement, without anything remotely resembling a major car shortage. In the same year they moved 54 billion miles of passenger traffic, exceeding the 1918 volume by 26 per cent.

In 1943 expansion has continued. Estimates for the year based on figures for the first seven months indicate a record-breaking freight traffic mark of around 725 billion ton-miles. This would represent an increase of 80 per cent over the business handled under government operation twenty-five years ago and an expansion over 1939, the last pre-war year, of 118 per cent. The passenger-carrying performance has been even more spectacular. Latest figures point to a total for 1943 of around 80 billion passenger miles—almost double the 1918 figure and more than three times that of pre-war 1939. It should be remembered that in 1939 the railroads were carrying only about one-third the number of passengers handled in the record year 1920. Naturally the roads had retired much passenger equipment, and in 1941 they had only half as many passenger locomotives as in 1920 and only two-thirds the number of passenger-carrying cars.

The roads have had not only to handle an enormous expansion in their usual business; they have had to take up burdens which other transportation agencies, through no fault of their own, have been compelled to put down. A striking example has been the effort by which the railroads prevented the oil shortage in the East from developing into a crisis of the first magnitude. Before the war 95 per cent of the gasoline and oil for the East came by sea in tankers. The railroads delivered only about 10,000 barrels a day. Experts said that in an emergency they might be able to raise this to 200,000 barrels. Then the U-boats struck. Tankers were sunk or diverted to supply distant fronts. By the end of June, 1943, the railroads were delivering oil to the East at a rate of more than 1,000,000 barrels a day, one hundred times the pre-war volume, and at reduced freight rates.

Since the war the railroads have had to replace the services of shipping on the Atlantic, Gulf and Pacific coasts, and the commercial intercoastal shipping through the Panama Canal (this last alone amounted to 29,000,000 tons in 1939). In normal times, for example, much of the coal from West Virginia and Kentucky goes to Norfolk by train and thence by ship to New England. During the war millions of tons of this coal has had to be hauled all the way to its destination by rail. (Fortunately, water movement of coal has now been resumed.) Before the war, much of the Pacific Coast lumber, canned goods and other freight moved to the East by way of the Canal. Today this transcontinental traffic moves by rail. A substantial volume of shipping from the Caribbean is now landed at ports in the South for movement north by rail. The railroads have had to take over some of the traffic which formerly moved on the highways—not merely because of tire and "gas" shortages, but because of the suspension of the manufacture of new trucks except for military purposes and a growing scarcity of repair parts. It is estimated that as a result of such traffic shifts the railroads have absorbed 90 per cent of the wartime expansion in the nation's freight traffic and 75 per cent of the increase in passenger traffic.

Military travel has provided a special problem. It is estimated that in 1942 troop movements were four times heavier than in World War I, and this year they are running some 70 per cent higher than last. The magnitude of the task is illustrated by the fact that the transportation of a triangular infantry division of 15,000 men, with their equipment, requires 65 trains, with a total of 1,350 cars. From 40 to 50 per cent of the country's sleeping cars are continuously in use by the military. Movement of troops in emergencies, such as the shift westward after Pearl Harbor, constitutes one of the finest pages in the railroad's war history.

Equipment and Labor Problems

A striking — and disturbing — contrast between this war and the last is to be found in the present problem of obtaining equipment and manpower. Although the total increase in traffic between 1940 and 1942 was six times as great as that between 1916 and 1918 the railroads, because of shortages of materials, have

been able to buy less than one-third the number of engines added during World War I and less than three-quarters as many freight cars. As to labor, some idea of the extent of the turnover is indicated by the fact that the carriers were compelled to hire approximately 1,000,000 new workers during the last fiscal year alone.

The dangers that are inherent in such acute equipment and labor shortages have been unhappily shown in recent weeks by a number of passenger train wrecks. Joseph B. Eastman, director of the Office of Defense Transportation, commenting on these wrecks, pointed out that the roads are being forced "to drive their equipment as it never has been driven before," while at the same time suffering from a great turnover in employment, which forces them to use more and more "green hands."

Despite the accidents, the overall wartime safety record has been extraordinary in view of the volume of traffic handled. Although passenger miles this year will practically double the 1918 total, passenger fatalities have averaged 22 per month, compared with 40 per month in that year. The record for the first eight months shows one passenger fatality for every 400 million passenger miles.

What Is Behind the Record?

How can we account for the fact that the railway system, which faltered so badly in World War I, has met so successfully the infinitely greater test imposed by World War II? The story is one which covers a period of twenty years. It is a story of private enterprise, investment, and competition at work.

Preparations of the railroads for the present war did not begin with Pearl Harbor. They began as far back as 1920, when wartime government operation was ended and the lines were turned back to their owners. Under the Transportation Act of that year it was provided that the carriers should be permitted to earn a "fair return" of 5¾ per cent on their investment. Relying on the good intentions of this Act, the railroads, following the short post-war depression of 1921-1922, launched the program of rehabilitation which laid the foundation for their brilliant performance twenty years later.

It was in 1923 that the roads announced their first "billion-dollar spending program." Between 1923 and 1941—despite the intervention of the depression—they expended approximately $10,500,000,000 on capital account, which resulted, after allowing for retirements, in a net increase of $5,200,000,000 in investment in road and equipment. Of this total about $5,000,000,000 represented improvement of tracks, gradings, sidings, terminals and other elements of the fixed railroad plant; the rest went into rolling stock.

The implied promise held out by the Transportation Act of 1920—the "fair return" of 5¾ per cent—was not fulfilled in the two decades that followed. Over that span of twenty years the railroads averaged a return on their investment of barely 3 per cent, and never in any year reached 5 per cent. It has been said that during this period the railroads were "subsidized by their security holders", and the observation contains more than a grain of truth. The fact is that between 1923 and 1941 railroad capital in the hands of the public increased by less than $300,000,000. The rest of the vast program of rehabilitation was financed out of earnings.

Belief that the railroads could be guaranteed a return rested upon the assumption that they enjoyed a monopoly in the field of intercity transportation. However much this may have been true before World War I, it had already ceased to be the case in the early 'twenties, and the two decades that have ensued have seen the carriers compelled to face steadily increasing competition from inland and coastal waterways; from such forms of motorized transport as the truck, the bus and the private passenger car; from long-distance pipe lines, and more recently from the airplane.

Obviously no rate-making agency, under such circumstances, could "guarantee" the railroads a fair return on their investment. It could not even guarantee them financial survival. If that was to be achieved, as they soon came to realize, it was up to the railroads themselves to achieve it by meeting the challenge of the new competition in terms of rates and service. The depression of the 'thirties increased their task by reducing the volume of transportation business available, but it also intensified and speeded up their efforts to improve management, operating efficiency and cooperation with the shipping and traveling public. In the fierce competition of the 'thirties many roads were forced to the wall financially, and to this extent improved efficiency was achieved in considerable part, of course, through the financial sacrifice of the investors.

Technological Progress

Money, science and ingenuity have been poured into this vast task of rehabilitation of the nation's carriers in the last two decades. The extent of the revolution in operating methods may be summed up, perhaps, in the single statistical fact that the performance of the average freight train today, in load carried and speed of movement, is nearly 120 per cent greater than it was in 1918. Behind that overall figure is a myriad of contributing factors. Roadbeds have been improved and curves and grades reduced or eliminated. The steel rails of today are heavier than they were 20 years ago and, thanks to advances in the science of

metallurgy, they are made of sturdier and longer-wearing metal. Double-tracking has replaced single tracking over large parts of the nation's railroad system, with the result that although more than 23,000 miles of line have been abandoned since World War I, total trackage has increased from 397,000 to 404,000 miles. Modern signal systems increase the efficiency of this trackage.

"More power" has been an outstanding development of the last twenty years. Though there are fewer locomotives in service today, they are better locomotives, better cared for and better handled, and turn in vastly more work. They travel 56 per cent farther in a day, pull loads half again as heavy and keep those loads rolling much faster than their World War I predecessors. Thousands of miles of road have been electrified. Big Diesel-electric locomotives, with speeds of over 100 miles an hour, have been put into service. The average steam engine of 1918 had a tractive effort of less than 35,000 pounds. Today's average engine is rated at nearly 52,000. But that is only an average. There are, for example, the "Big Boys" on the Union Pacific, with a rating of 135,000 pounds tractive effort, capable of hauling a mile-long freight train more than a mile a minute. Some of the giant Diesels rate as high as 220,000 pounds.

Just as some 41,000 locomotives have been scrapped since 1923 to make way for their more efficient modern counterparts, so has the old wooden box car undergone a rejuvenation. Its successor is built of lightweight steel and on the average will carry nine tons—25 per cent—more freight. This new equipment is not only bigger and stronger, but it is tougher.

Changes in operating methods have kept pace with improvements in plant. One of the principal developments of railroading in recent years has been the increasing length of railroad runs and the replacement of the old "slow freight" with modern through freights which, like passenger trains, run on regular schedule. New signal systems help keep them rolling. Centralized train control enables a man in a central office to follow the exact progress of many freight trains. Where two lines cross he can slow one train down just enough to let the other get past. What this means in time saved may be judged from the fact that once a heavy freight train has stopped about half an hour is required for it to regain full speed.

The handling of freight at terminal points has undergone many changes in the past twenty years. The old-fashioned switch engine is rapidly becoming a thing of the past—replaced by fast-maneuvering Diesels which do not have to go to the "ash-track" every few hours to have their clinkers removed and their fires virtually rebuilt. Electric "mules" and high-lift trucks, which handle 10,000-pound loads with ease, do much of the work once done manually and piecemeal.

Once a freight car was either a box-car, a flat car, a gondola or a tank car. Today, the number of specialized types of freight cars is legion — with each of them doing its share to simplify and streamline the handling of the load. There are a hundred different kinds of tank cars alone, designed to carry everything from crude oil to ice cream. Not only are cars loaded by mechanical devices, but at some points giant rotary dumpers are in use which can grip an open-top car carrying 120 tons of coal or ore, dump it, and return it to its normal position — all within a minute and a half. Helping to increase the loading of cars to maximum capacity are the freight consolidating and forwarding companies — largely a development of the last few years — which round up l.c.l., freight and mobilize it in carload lots.

Organization of Freight Movement

Also to be noted are the organizational changes in connection with the freight movement of the carriers. Without central direction today's wartime traffic would swamp the roads. Such direction is provided by the Car Service Division of the Association of American Railroads. This division knows the location of every car in the country at all times. Keeping in close touch with government, military and private shippers, it can anticipate any unusual freight movement. Working in close harmony with the Car Service Division are the Shippers Advisory Boards, the connecting link between the shippers and the railroads. Forecasts made by these Boards guide the judgment of the Car Service Division in providing the cars when and where they are needed. The estimates of the Boards in recent years have been accurate, on the average, within less than 4 per cent.

Government policy during the war also has been admirably designed to achieve a maximum of cooperation and coordination in the transportation effort. Near the close of 1941 the President, by Executive order, set up the Office of Defense Transportation, directed to "assure maximum utilization of the domestic transportation facilities of the nation." Domestic transportation, as defined in the order, includes railroad, motor, inland waterway, air transport and intercoastal shipping. Joseph B. Eastman, head of the Interstate Commerce Commission, was named director. The agency does not manage or operate the carriers, but facilitates and expedites measures necessary to the effective functioning of transport.

The Government, through the able head of the O.D.T.; the carriers, through the Association of American Railroads, and the Army and Navy (both of which have wisely placed ex-

perienced transportation men at the head of their traffic organizations) have adopted as their slogan: "Never load a freight car until you know you can unload it promptly". Not only is this accepted policy, but the parties concerned have made it effective. If unloading facilities at a seaboard terminal are overtaxed —the bogey of World War I — the Car Service Division issues an embargo halting further shipments to that port until the congestion is relieved. If a big manufacturer "hogs" idle freight cars on his sidings the Car Service Division can embargo his plant, and no more supplies will be moved in or out until it cooperates in keeping the cars moving. Moreover, the shippers have created 500 vigilance committees to check on receivers of freight and see that they "Get 'em empty and get 'em back".

Freight Car Capacity

Germany's Propaganda Minister, in his memorable broadcast of a year and a half ago, based his prediction of an American transportation breakdown on the fact that we had half a million fewer freight cars going into World War II than we had in World War I. What Herr Goebbels, along with many others, failed to understand was how the improvement in railway plant and equipment over the last twenty years, plus the more intensive utilization of that equipment, had transformed the 1,800,000 cars of 1942 into the equivalent of more than double that number. This discussion may be concluded with a brief presentation of the picture in terms of freight cars — a presentation which shows that while Herr Goebbels' figures were correct, his conclusions were fantastically wrong.

In round figures, the number of freight cars available in 1918 was 2,400,000 — in 1942 1,800,000

But the 1942 cars had an average capacity 25 per cent greater than those of 1918. This raises their aggregate capacity, in terms of 1918 cars, to 2,250,000

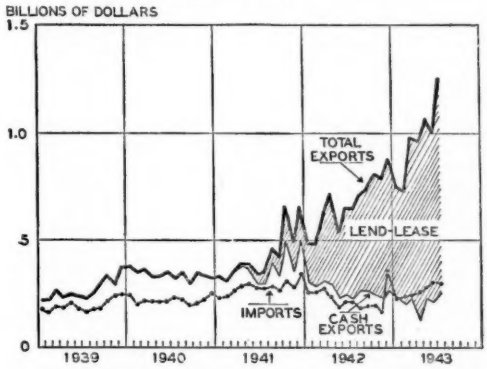
Moreover, the modern freight car is loaded 10 per cent nearer to capacity than that of World War I. This raises the figure again, this time to 2,475,000

But, what is even more important, the average freight car today is moved 50 per cent faster, with less terminal and loading and unloading delays. In other words, it makes 3 round trips for every 2 made by its 1918 predecessor. Which is simply another way of saying that, instead of boasting but 1,800,000 freight cars (1918 type and efficiency) the railroads, at the beginning of the second World War actually had, for all practical purposes 3,712,000

(A second article on the railroads, discussing their financial situation and future problems, will appear in this Letter next month).

Trade Balances and Latin American Inflation

The flood of war materials pouring from American production lines in recent months is being reflected in an expansion of exports from this country to totals far beyond anything ever known. In July, the month when the Allies landed on the beaches of Sicily, our exports shot up to a new record of about $1,250 millions, not including shipments to our armed forces. As will be seen from the accompanying diagram, this figure topped the previous monthly record by some $200 millions. It came within about $350 millions of the total for the full year 1932. It will not be surprising if exports for all of 1943 reach the staggering figure of $13 billions. Our previous export record of about $8.2 billions was established in 1920, and approximately equalled again in 1942.



Wartime U. S. Foreign Trade, Including Lend-Lease Exports.

Despite these exports, the country has become a debtor in its "cash" trade. The explanation, of course, is that the bulk of exports, some 80 per cent, now consists of lend-lease goods. Exports of non-lend-lease goods, or "cash" exports, have declined not only in proportion of the total, but in actual figures. They have reflected the concentration of industry, trade and shipping on the war effort. Imports, on the other hand, have expanded, particularly since shipping improvement has made it possible to bring in not only more raw materials for the war plants, but more of foods and other goods essential for the civilian population. The chart shows that imports are now running at the level of about $300 millions a month, or nearly 50 per cent more than last fall and winter. Some of the increase reflects higher prices, but the volume has risen also.

If only "cash" exports are considered, the balance in our foreign trade accounts has probably been running against us since the beginning of this year. The adverse balance through the end of July has exceeded $350 millions, and the trend continues.

Dollar Balances of Foreign Countries Growing

The excess of "cash" imports over "cash" exports creates dollar balances for the countries selling to us; and in conjunction with substantial American military expenditures, loans, and investments in some of those countries, which also provide them with dollars, it has brought about a great change, temporarily at least, in their international financial position.

According to Department of Commerce figures, our merchandise "cash" trade with Latin America produced an import balance of $88 millions for the first quarter of 1943, and one of $121 millions for the second quarter. Thus for the first six months, Latin American countries had $209 millions to their credit in their trade with us. The corresponding figure for 1942 was $163 millions. Overall balances of these countries have been even more favorable than the dollar figures alone show, because they have also had active trade balances with Great Britain and the European neutrals, Sweden, Spain and Switzerland, with whom some trade is still possible.

In the first six months of this year, the export surpluses of Latin American countries, together with foreign expenditures and other capital imports, increased the combined gold and foreign exchange balances of Latin American central banks and governments by nearly $600 millions. These holdings were computed by us to be the equivalent of about $1,300 millions last December. By July we estimate they rose to almost $1,900 millions.

One of the largest increases took place in Argentina where holdings of gold and foreign exchange by the Banco Central by the middle of July reached almost 2¼ billion pesos, equivalent to about $850 millions, in contrast with $658 millions as of the end of December 1942. The favorable trade balance, the chief factor in the accumulation of these reserves, amounted for the first seven months to 547 million pesos ($163 millions) as against 278 million pesos ($83 millions) in the same period last year. However, this increased export surplus was not due to expansion of exports, which were up only $6 millions, but to a $74 million drop in imports. The volume of imports has dropped another 30 per cent below last year's level, which was reported to be the lowest in about 50 years.

Almost one-half of Argentina's export surplus this year has originated in trade with the British Empire, and as a result her blocked sterling balances recently rose, according to the Minister of Finance, Mr. Jorge A. Santamarina, to about £42 millions ($168 millions). Because the British Food Ministry's recent agreement to buy the entire exportable meat surplus until September 1944 would have meant a further substantial increase in the frozen funds, the Minister of Finance has announced a plan to use some £32 millions of these funds for redemption of the Argentine bonds held in Great Britain. Presumably most of the sterling funds are in the name of the Banco Central, which has acquired them from the Argentine exporters, and a government bond issue will be sold internally to raise the funds to reimburse the bank.

Some 100 million pesos (over £7 million) of the British-held Argentine public and private debt has already been repatriated, in 1941 and 1942. Redemption of foreign debt is sound policy for Argentina; her balance of payments will be strengthened through the reduction of the annual debt service, and if the internal obligations to be issued are sold to the public, without creating bank credit expansion, they will absorb excess purchasing power which is exerting inflationary pressure.

The gold reserve of the Brazilian Government and the net foreign assets of the Banco do Brazil apparently rose during the first seven months of this year by over $130 millions to about $370 millions. Besides export surpluses, our military expenditures and loans have been important in building up these reserves. Our Export-Import Bank's interest in one enterprise alone, the great Volta-Redonda steel plant, has now been increased to $45 millions. The agreement made in 1937, which authorized Brazil to buy here up to $50 millions of gold, has recently been amended to raise the limit to $200 millions, but even this amount may not be sufficient for long if Brazil desires gold for her accumulating balances.

The gold and foreign exchange reserves of the Mexican Central Bank, Banco de Mexico, were reported to have reached the equivalent of over $200 millions in July. In addition, commercial banks held in June about $26 millions in foreign exchange.

In Colombia gold and foreign exchange holdings have increased almost 50 per cent since the beginning of the year, to $90 millions. Venezuela and Chile (where the Central Bank expects to acquire this year from two to three times as much foreign exchange as in 1942) likewise continue to accumulate gold and foreign exchange, as do Central American republics.

Credit Expansion and Inflation

While the piling up of gold and foreign exchange reserves provides greater security behind the currencies of Latin American countries, the expansion in purchasing power which these accumulations represent has given cause for concern. It has brought about competition for available goods, the output of which has not kept up with the expansion of purchasing power. This has been either because industrial products could not be im-

ported from belligerent countries, or because goods could not be produced at home as a consequence of the lack of machinery, spare parts and even fuel. As the Argentine Central Bank report for 1942 put it, "industry in general would seem to be approaching maximum production, unless imports of machinery and essential materials can be increased—which, as far as can be foreseen at present, is not probable."

The influence of this expansion of purchasing power on prices and wages is appearing in an acceleration of the rising trend in many countries. The wholesale price level in Peru advanced another 10 per cent from January to June and is more than twice as high as before the war, while in Bolivia the cost of living is now three times that of pre-war. Similar rises took place in Chile earlier. In Colombia and Costa Rica food prices advanced more than 15 per cent from January to June, and in Mexico over 25 per cent.

Mexico's Inflation Problem

Mexico, now in the midst of an unprecedented boom, provides perhaps the best illustration of the problems facing Latin America in general. The abnormal expansion in the means of payment in Mexico has been brought about by a large export balance, reflecting the wartime demand on the country's resources and a serious decline in imports, the spending of tourists, remittances of Mexican workers in this country, and above all by the influx of foreign funds which in many cases are seeking only temporary refuge. In one year the total of sight deposits plus currency in circulation increased by over one billion pesos, to a new high of 2.5 billions in July. Because of limited investment opportunities immediately available, the excess funds have stimulated speculation not only in common stocks and real estate but also in commodities. Meanwhile the available volume of goods has diminished because of smaller imports, poorer crops and transportation difficulties, while rising prices have stimulated the turnover of deposits.

Only about 200 million pesos have been placed in long-term investments, according to the August Review of the Banco Nacional de Mexico, while time and savings deposits increased but 36 million pesos during the first half of this year. To limit the excessive use of credit, a ceiling has been placed on the volume of loans that banks may make. Bank reserve requirements have been raised somewhat and the Mexican Government has also been putting new gold and silver coins into the hands of public in order to reduce paper circulation. The gold coins are being sold at premiums ranging from 3 to 5 per cent.

Variations of these measures to limit inflation are employed elsewhere in Latin America. Internal loans are being floated in Venezuela, Colombia, Brazil and, as already noted, in Argentina, for the purpose of absorbing purchasing power. For some months the inflow of funds into the Argentine and Colombia has been under control. Elsewhere bank reserve requirements have been raised. Price controls have been generally extended, — in some countries with the advice of our own Office of Price Administration. Newly-mined gold and silver, the sale of which used to bring to individual Latin American mining countries foreign exchange equivalent to more than $100 millions in recent years, is being retained at home to an increasing extent. This is implied from our net imports of gold and silver from Latin America, which declined during the first six months of this year some 70 per cent, from $73 millions in 1942 to only $21 millions. Shipments of Mexican silver, now bought exclusively by the National Bank, have been suspended and are not to be resumed until next May. The surplus in the Mexican balance of international payments should be cut down somewhat as a result.

Nevertheless, the danger of inflation will continue, the more so as the improved shipping situation may permit further expansion in Latin American exports, without much chance of obtaining compensatory imports. More money will be flowing to the Caribbean countries for larger exports of sugar, molasses and bananas. Venezuela will benefit from expanded shipments of petroleum and Brazil and Peru from larger exports of raw cotton, vegetable oils and other products. Cuba's exports alone should increase next year some $60 to $70 millions, in view of the larger sugar crop and heavier molasses exports.

Already the changes taking place in Latin America have brought about a striking reversal of pre-war conditions, which were characterized by shortage of capital and instability of currencies. The wartime developments are placing many of the Latin American economies under severe strain due to import shortages and inflationary dangers. Yet the difficulties have major compensations in the way of foreign exchange stability and increased supplies of capital. The immediate problem is to prevent the present boom and price rise from going too far. If they can do so, individual Latin American nations will emerge in a strong position. Their large cash reserves will enable them to make up goods shortages from which they are now suffering, as the goods become obtainable. Doubtless they are also considering the extent to which their balances should be conserved for post-war currency stabilization, which in last analysis can only be achieved by appropriate policies of individual countries.

The National City Bank of New York

Head Office · 55 WALL STREET · *New York*

Condensed Statement of Condition as of September 30, 1943

ASSETS

Cash and Due from Banks and Bankers	$ 765,818,002.83
United States Government Obligations (Direct or Fully Guaranteed)	2,193,237,927.24
Obligations of Other Federal Agencies	38,528,171.56
State and Municipal Securities	161,629,183.96
Other Securities	35,197,103.41
Loans, Discounts and Bankers' Acceptances	764,599,053.98
Real Estate Loans and Securities	4,840,760.83
Customers' Liability for Acceptances	5,697,028.80
Stock in Federal Reserve Bank	4,875,000.00
Ownership of International Banking Corporation	7,000,000.00
Bank Premises	37 122,480.01
Other Assets	1,261,440.99
Total	$4,019,806,153.61

LIABILITIES

Deposits		$3,799,031,593.59
(Includes United States War Loan Deposit $731,558,562.77)		
Liability on Acceptances and Bills	$8.767,338.38	
Less: Own Acceptances in Portfolio	2,886,732.37	5,880,606.01
Items in Transit with Branches		6,959,959.52
Reserves for:		
Unearned Discount and Other Unearned Income		1,499,053.52
Interest, Taxes, Other Accrued Expenses, etc.		13,665,430.76
Dividend		1,550,000.00
Capital	$77,500,000.00	
Surplus	85,000,000.00	
Undivided Profits	28,719,510.21	191,219,510.21
Total		$4,019,806,153.61

Figures of foreign branches are included as of September 25, 1943, except those for enemy-occupied branches which are prior to occupation but less reserves.

$902,397,815.79 of United States Government Obligations and $6,375,375.49 of other assets are deposited to secure $853,419,378.22 of Public and Trust Deposits and for other purposes required or permitted by law.

(*Member Federal Deposit Insurance Corporation*)

City Bank Farmers Trust Company

Head Office · 22 WILLIAM STREET · *New York*

Condensed Statement of Condition as of September 30, 1943

ASSETS

Cash and Due from Banks	$ 35,064,204.81
United States Government Obligations (Direct or Fully Guaranteed)	111,025,116.41
Obligations of Other Federal Agencies	524,861.69
State and Municipal Securities	2,002,818.48
Other Securities	842,707.62
Loans and Advances	2,315,061.75
Real Estate Loans and Securities	6,741,110.37
Stock in Federal Reserve Bank	600,000.00
Bank Premises	3,587,366.25
Other Real Estate	148,669.88
Other Assets	2,553,691.45
Total	$165,405,608.71

LIABILITIES

Deposits	$137,727,654.30
(Includes United States War Loan Deposit $47,184,536.50)	
Reserves	1,847,851.05
Capital	10,000,000.00
Surplus	10,000,000.00
Undivided Profits	5,830,103.36
Total	$165,405,608.71

$49,330,213.74 of United States Government Obligations are deposited to secure $47,184,536.50 of Public Deposits and for other purposes required or permitted by law.

(*Member Federal Deposit Insurance Corporation*)

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